No. 85-521

In the Supreme Court of the United States

OCTOBER TERM, 1985

OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, ET AL., APPELLANTS

v.

PUBLIC AGENCIES OPPOSED TO SOCIAL SECURITY ENTRAPMENT, ET AL.

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

STATE OF CALIFORNIA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLANTS

CHARLES FRIED
Solicitor General

RICHARD K. WILLARD
Assistant Attorney General

KENNETH S. GELLER
Deputy Solicitor General

CHARLES A. ROTHFELD
Assistant to the Solicitor General

WILLIAM KANTER
DOUGLAS LETTER
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether Section 103(a) of the Social Security Amendments Act of 1983, 42 U.S.C. (Supp. I) 418 (g), effected a "taking" of property within the meaning of the Fifth Amendment by preventing states from withdrawing from the Social Security System.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, plaintiffs in the district court were the Yorba Linda Library District, the North Bakersfield Recreation and Park District, the Delano Mosquito Abatement District, Katherine T. Citizen, William Rasmussen, and Margie Hunt. Defendants in the district court included, in addition to the parties named in the caption, John Svahn. Named as "real parties in interest" were George Deukmejian, Michael Franchetti, the Board of Administration of the Public Employees Retirement System of the State of California, Robert F. Carlson, Bill D. Ellis, Jake Petrofino, Prescott R. Reed, Wilson C. Riles, Jr., Mel Reuben, Jack G. Willard, Brenda Y. Shockley, and Susan Tohbe.

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OPINION BELOW

The opinion of the district court (J.S. App. 1a-35a) is reported at 613 F. Supp. 558.

JURISDICTION

The judgment of the district court (J.S. App. 36a) was entered on May 31, 1985. A notice of appeal (J.S. App. 37a-38a) was filed on June 27, 1985. On August 19, 1985, Justice Rehnquist extended the time

for docketing the appeal through September 25, 1985. The jurisdictional statement was filed on that date; the Court noted probable jurisdiction on December 2, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1252.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

42 U.S.C. 418(a)(1) reads in relevant part:

> The Secretary of Health and Human Services shall, at the request of any State, enter into an agreement with such State for the purpose of extending the insurance system established by this subchapter to services performed by individuals as employees of such State or any political subdivision thereof. Each such agreement shall contain such provisions, not inconsistent with the provisions of this section, as the State may request.

42 U.S.C. (Supp. I) 418(g) reads:

> No agreement under this section may be terminated, either in its entirety or with respect to any coverage group, on or after April 20, 1983.

42 U.S.C. 1304 reads:

> The right to alter, amend, or repeal any provision of this chapter is hereby reserved to the Congress.

The Fifth Amendment to the Constitution reads, in relevant part:

> [N]or shall private property be taken for public use, without just compensation.

STATEMENT

1. Congress created the Social Security System in 1935 to serve as the Nation's basic social insurance program. Ch. 531, §§ 201 *et seq.*, 49 Stat. 622 *et seq.* The System, which now provides benefits to aged, ill and disabled individuals, is financed through mandatory payments by current employees and their employers (at present, 7.15% of the employee's first $42,000 of wages). See 26 U.S.C. 3101(a) and (b); 42 U.S.C. (Supp. I) 430(c); 50 Fed. Reg. 45558, 45559 (1985).[1] For most employees and employers, participation in the System is mandatory; as of 1983, 115 million workers, or approximately 90% of the American workforce, were covered by the System. H.R. Rep. 98-25, 98th Cong., 1st Sess. Pt. 1, at 13 (1983).[2]

As originally enacted, the Social Security Act, 42 U.S.C. 301 *et seq.*, excluded state and local government employees from participation in Social Security. See 42 U.S.C. 410(a)(7). In 1950, however, Con-

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[1] Benefits received by current retirees are financed not by their past payments, but rather "by current workers paying social security taxes—each working generation pays for the benefits being paid to the previous generation now retired." Subcomm. on Social Security of the House Comm. on Ways and Means, 97th Cong., 2d Sess., *WCMP: 97-32, Termination of Social Security Coverage for Employees of State and Local Government and Nonprofit Groups* 4 (Comm. Print 1982). The System thus has a " 'pay-as-you-go' financing structure." *Ibid.*

[2] Employees who were not covered in 1983 included approximately 2.4 million federal workers (who were protected by a separate federal retirement program), more than 3 million employees of state and local governments, and some 1 million employees of nonprofit organizations. H.R. Rep. 98-25, *supra*, at 13. A number of these workers have since been brought withir the System. See note 10, *infra*.

gress amended the Act to permit the states voluntarily to enroll their employees, and those of their political subdivisions, in the System. Social Security Act Amendments of 1950, ch. 809, § 106, 64 Stat. 514, codified at 42 U.S.C. (& Supp. I) 418. Specifically, Section 418 authorized the federal administrator of the System (now the Secretary of Health and Human Services (the Secretary)), "at the request of any State, [to] enter into an agreement with such State for the purpose of extending the [Social Security] insurance system * * * to services performed by individuals as employees of such State or any political subdivision thereof." 42 U.S.C. 418 (a)(1).

Pursuant to these so-called "Section 418 agreements"—which must "contain such provisions, not inconsistent with the provisions of [Section 418] as the State may request" (42 U.S.C. 418(a)(1))—participating states may enroll all, or only specified "coverage groups," of their employees. 42 U.S.C. 418(c). See 42 U.S.C. 418(b)(5); Subcomm. on Social Security of the House Comm. on Ways and Means, 97th Cong., 2d Sess., *WMCP: 97-32, Termination of Social Security Coverage for Employees of State and Local Government and Nonprofit Groups* 1 (Comm. Print 1982) [hereinafter cited as H.R. Comm. Print 97-32].[3] The Act thus leaves it to the state to determine which of its employees, and which

[3] Section 418 originally permitted the extension of Social Security coverage only to state employees who were not already protected by a retirement system, while entirely excluding certain types of public employees from the System (64 Stat. 515). The Section has since been amended to permit virtually all state and local government employees to participate in Social Security.

local government employees, will be enrolled in the System; individual employees or coverage groups may not elect on their own to join (or to refuse to join) the System. See H.R. Comm. Print 97-32, at 1, 5.[4]

States that elect to participate in the System are responsible for collecting and periodically paying to the Secretary of the Treasury "amounts equivalent to the sum of the taxes" that would be due if their employees otherwise were covered by the Act (42 U.S.C. (& Supp. I) 418(e)(1)), and the other requirements imposed upon the states generally are the same as those placed on private employers by the Act. See 42 U.S.C. 418(i). The Secretary may impose interest penalties for late payment. 42 U.S.C. 418(j). The statute also makes provision for the assessment of amounts due (42 U.S.C. 418(q)), for the administrative determination of challenges to assessments and claims for refunds (42 U.S.C. 418 (s)), and for judicial review of such determinations (42 U.S.C. 418(t)).

Following the enactment of Section 418, all 50 states executed agreements with the Secretary to obtain Social Security coverage for their own employees or for those of their political subdivisions.[5] And the percentage of state and local government employees enrolled in the System through Section 418 agreements increased dramatically, from 11% in 1951 to

[4] The Act creates an exception to this rule for state employees who already are covered by a retirement system; a majority of such employees must agree to be covered by a Section 418 agreement. 42 U.S.C. 418(d)(3).

[5] Only five states—Alaska, Maine, Massachusetts, Nevada, and Ohio—currently do not have their own employees enrolled in the Social Security System. See H.R. Rep. 98-25, *supra*, at 17.

70% in 1970. H.R. Comm. Print 97-32, at 24. The percentage of such employees covered by Section 418 agreements has remained roughly constant since then (see *ibid.*); as of 1983, some 9.4 million of the approximately 13.2 million state and local government employees in the United States were participants in the Social Security System. H.R. Rep. 98-25, *supra*, at 17.

2. As originally enacted, Section 418 provided that a participating state could elect to terminate its Section 418 agreement, in whole or in part, upon two years' notice to the Secretary. 42 U.S.C. 418(g).[6] During the statute's first two decades of operation, virtually no states or subdivisions chose to withdraw from the System. H.R. Rep. 98-25, *supra*, at 18; H.R. Comm. Print 97-32, at 26.[7] From 1977 on, however, the number of withdrawals increased significantly. Between 1977 and 1981, 96,000 state and local government employees were withdrawn from the System; by 1983, termination notices were pend-

[6] Only the states were given the authority to file notices of withdrawal, although they were permitted to do so on behalf of local governments; Section 418 did not require a participating state to consult with or inform affected employees before making a decision to terminate coverage. See H.R. Comm. Print 97-32, at 5. Some limits on the state's ability to terminate Section 418 agreements were imposed, however: the state could tender a termination notice for a given coverage group only after the Section 418 agreement enrolling that group in the System had been in effect for at least five years. 42 U.S.C. 418(g)(1)(A) and (B). Once a group's coverage had been terminated, that group could not be reenrolled in the System. 42 U.S.C. 418(g)(3).

[7] Indeed, from 1950 through 1966, 23 public entities representing a total of only 319 workers withdrew from the System, which at that point covered well over 5 million state and local government employees. H.R. Comm. Print 97-32, at 25.

ing for 634 state and local entities representing an additional 227,000 employees. H.R. Rep. 98-25, *supra*, at 18. See S. Rep. 98-13, 98th Cong., 1st Sess. 99 (1983).[8]

In that year, Congress determined that the continued and accelerating withdrawal of employees by states and localities was threatening the integrity of the Social Security System and the System's role as the Nation's basic insurance program. It concluded that permitting states and localities to terminate Social Security participation for their employees was inequitable both for the workers who lost coverage and for the employees who continued to pay into the system. H.R. Rep. 98-25, *supra*, at 18-19. And it noted that withdrawals at the current rate would cost the Social Security trust funds $500 million to $1 billion annually. H.R. Comm. Print 97-32, at 13-14; S. Rep. 98-13, *supra*, at 104; S. Rep. 98-23, 98th Cong., 1st Sess. 2, 13 (1983).

As part of the Social Security Amendments Act of 1983 (the 1983 amendment), Pub. L. No. 98-21, 97 Stat. 65 *et seq.*, Congress accordingly amended Section 418(g) to provide that "[n]o agreement under this section may be terminated, either in its entirety or with respect to any coverage group, on or after April 20, 1983."[9] This amendment prevents

[8] Of these, 287 governmental units employing 104,000 persons were scheduled to withdraw from the program at the end of 1983 (J.A. 61).

[9] Prior to this amendment, the Secretary was authorized to terminate a Section 418 agreement upon finding that the state involved was unable to comply with the agreement or with the Act. 42 U.S.C. 418(g)(2). This provision was eliminated by the 1983 amendment. The amendment also permitted coverage groups that previously had withdrawn to rejoin the System. See Pub. L. No. 98-21, § 103(a), 97 Stat. 71.

a state from withdrawing its employees (or those of its political subdivisions) from the Social Security System even if a two-year termination notice had been filed prior to 1983 and was pending at the time that Section 418 was modified.[10]

3. At the time of the 1983 amendment to Section 418(g), appellee State of California—which has had a Section 418 agreement with the Secretary since 1951 (J.A. 29)[11]—had filed termination notices on

[10] Prior to 1983, employees of certain types of nonprofit organizations were excluded from the Social Security System unless the employing organization filed a certificate waiving its exemption from the System. 42 U.S.C. 410(a)(8)(B). Pursuant to such waivers, approximately 80% to 90% of the 5.3 million employees of nonprofit organizations participated in the System. Like state governments, however, nonprofit institutions were permitted to withdraw from the System upon two years' notice, and in 1983 termination notices were pending for 977 such organizations with 322,600 employees. H.R. Rep. 98-25, *supra*, at 15. In 1983, Congress accordingly made coverage for such employees mandatory by including them within the Act's basic definition of "employee." See Pub. L. No. 98-21, § 102(a)(1), 97 Stat. 70. At the same time, Congress provided that new federal employees would be enrolled in the System. § 101, 97 Stat. 67.

[11] After executing its Section 418 agreement with the Secretary, California enacted legislation permitting it to enter into agreements with public agencies that wished to participate in the System; these entities were to contribute their share of contributions to the State, and were to be permitted to withdraw from the System upon two years' notice to the State. Cal. Gov't Code §§ 22000-22603 (West 1980 & Supp. 1985). See J.S. App. 5a-6a. "[I]n effect, the public agencies were permitted to withdraw only if the State could terminate their enrollment, thus ending the State's own liability for the public agencies' participation" (*id.* at 6a).

At the time of the 1983 amendment to the Act, approximately 511,000 state and local government employees in California were covered by the System. The State did not seek to withdraw its own 100,000 employees from the System. J.A. 51.

behalf of approximately 70 of its political subdivisions with some 34,000 employees (J.A. 61). Those employees were to have been withdrawn from the System at the end of the year. The 1983 amendment, however, prevented the notices from taking effect.

In response to this development, these suits were brought in the United States District Court for the Eastern District of California to challenge the validity of amended Section 418(g). The first action was filed by one set of appellees—several public agencies of the State of California, their employees, local taxpayers, and a group called "Public Agencies Opposed to Social Security Entrapment" (POSSE)—who contended, in part, that the 1983 amendment deprived them of their contract rights without according them due process or just compensation. J.S. App. 9a-10a. The second suit was filed by the State of California, which claimed that Section 418(g) infringed the State's contract and violated the Tenth Amendment by impairing the State's ability to structure its relationships with its employees. J.S. App. 10a-11a. Both sets of appellees sought injunctive and declaratory relief.

The district court granted summary judgment to the appellees.[12] Reviewing California's Section 418 agreement with the Secretary, the court found that the "document evidences an agreement between the

[12] The court first ruled that it had jurisdiction, finding that all of the appellees had standing and that the Anti-Injunction Act, 26 U.S.C. 7421(a), was inapplicable. J.S. App. 11a-24a, 26a-28a.

parties signatory thereto, that each promises to do certain things and to assume certain obligations" (J.S. App. 30a). In the court's view, such an agreement is a contract and thus "property" within the meaning of the Fifth Amendment's Taking Clause (*id.* at 20a, 30a-31a). Similarly, the court found that the right to terminate an agreement on two years' notice, which appeared in the original version of Section 418(g) and was echoed in California's Section 418 agreement (see J.S. App. 4a-5a; J.A. 31), "is a contractual right running in favor of the public agencies." *Id.* at 21a.[13] While the court assumed that Congress would have had the authority to divest the State of its right to withdraw "if the right existed solely by virtue of the statute," here the ability to withdraw from the Social Security System "draws its independent existence from the plain terms of the contract."[14] The court therefore held that "Congress is simply not free to deprive the State of its contractual right without just compensation." J.S. App. 32a (footnotes omitted).

Although the district court thus found that the 1983 amendment to Section 418(g) effected a taking

[13] The court acknowledged that only the Secretary and California were parties to the Section 418 agreement (J.S. App. 15a-18a), but found that the public agency appellees were third party beneficiaries of the agreement (*id.* at 21a).

[14] The court also "assumed (without deciding) that such an imposition might pass constitutional muster even though the [Section 418] Agreement permits the State to withdraw from the *contract*. In such a case, the State's *contractual* right to withdraw would appear to be unaffected (thus a Just Compensation claim might be avoided), but the termination right would do the State no good since it would then be under a *statutory* obligation to participate in the Program." J.S. App. 3a-4a (emphasis in original).

of property, it concluded that it was not free to order payment of just compensation or to refer the case to the Claims Court for the award of that relief. The court reasoned that the purpose of the 1983 amendment was to "ensure an adequate financial basis for [the Social Security] system by requiring the states and their public agencies to contribute to the system," so that "requir[ing] the United States to pay just compensation by making the contribution for the public agencies is simply and clearly contrary to the will of Congress." J.S. App. 34a. The court therefore declared the amendment void, and ordered the Secretary to "accept the notifications of withdrawal properly tendered to her." *Id.* at 35a.

SUMMARY OF ARGUMENT

A. In assuming that Section 418 agreements are "contracts" that create vested rights, the district court committed a fundamental error. To be sure, Section 418 and the agreements consummated under its authority describe the conditions that govern state participation in the Social Security System; federal and state administrative officials must comply with those conditions, as they must with all aspects of federal law. But while Section 418 agreements thus have a "contractual aspect," "[u]nlike normal contractual undertakings" they implement a program that "originate[s] in and remain[s] governed by statutory provisions expressing the judgment of Congress concerning desirable public policy." *Bennett* v. *Kentucky Department of Education*, No. 83-1798 (Mar. 19, 1985), slip op. 11, 12. Arrangements of this sort generally are understood not to create vested rights, but rather to " 'declare[] a policy to be pursued until the legislature shall ordain otherwise.' " *National Railroad Pas-*

senger Corp. v. *Atchison, T. & S.F. Ry.*, No. 83-1492 (Mar. 18, 1985), slip op. 14 (citation omitted).

That Congress did not intend to create contractual rights here is confirmed both by the legislative history and by the structure of the Act. Virtually no attention was paid to the termination provision when Section 418 was enacted, evidently because it was assumed that few groups ever would seek to terminate coverage. And Congress, from the time of the creation of the Social Security program, has signalled its intention to retain flexibility in structuring the System by expressly reserving the power "to alter, amend, or repeal any provision of [the Act]." 42 U.S.C. 1304. Congress hardly can have expected legislation containing such a provision to give rise to static property interests.

It is true, of course, that the Section 418 program makes use of written agreements. But Congress provided that the states could join the System through individual agreements in an attempt to permit them to play a continued role in the provision of retirement and disability benefits to state and local government employees; written agreements obviously are necessary to memorialize these arrangements. It would turn this cooperative aim on its head, however—and ultimately would disserve state interests—to conclude that attempts to accommodate the states in federal regulatory programs give rise to contractual relationships that make changes in those programs constitutionally impermissible.

B. 1. Even on its own terms—considering California's agreement to be a contract—the district court's analysis is flawed. The agreement was written to effectuate Section 418, and expressly provides that it extends Social Security protection to state and local

government employees "in conformity with" that provision. Section 418, meanwhile, flatly provides that federal-state agreements may not contain terms that are "inconsistent with the provisions of this section." Because the termination provision of California's Section 418 agreement is now inconsistent with the amended Section 418, that provision is unenforceable.

2. The district court's reasoning also is inconsistent with this Court's repeated holding that "[c]ontractual arrangements remain subject to subsequent legislation by the presiding sovereign * * * unless [the sovereign's right to enact such legislation] 'has been specifically surrendered in terms which admit of no other reasonable interpretation.'" *Merrion* v. *Jicarilla Apache Tribe*, 455 U.S. 130, 147-148 (1982) (citation omitted). There is absolutely nothing in California's Section 418 agreement that purports to insulate appellees from the effects of legislative changes in the System, or to guarantee that Congress will not enact supervening legislation obviating the agreement altogether by requiring the states to participate in Social Security. And again, Section 1304 confirms that Congress did not intend to abandon its sovereign authority to adjust, through legislation, the Social Security obligations of state and local employers.

Congress thus could have ignored the outstanding agreements and simply enacted legislation permanently bringing into the System those state and local employees who already are covered—as the district court itself evidently recognized. And if Congress retained the authority to take such action, it is absurd to suggest that the 1983 amendment is constitutionally suspect because Congress achieved the same result by modifying existing Section 418 agreements. Indeed,

the Court has squarely rejected the contention that, "in a statute such as this, regulating purely economic matters, * * * Congress' choice of statutory language can invalidate the enactment when its operation and effect are clearly permissible." *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 23-24 (1976).

C. If, on the other hand, the district court meant to conclude that Section 418 agreements must be construed in a way that would prevent Congress from making essential modifications in the System, its holding is inconsistent with this Court's oft-stated admonition that sovereign authority "cannot be contracted away." *North American Commercial Co.* v. *United States*, 171 U.S. 110, 137 (1898). See, *e.g.*, *United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 23 (1977); *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 108-109 (1938). Applying this principle, the Court repeatedly has rejected challenges to legislative action abrogating contractual obligations that purported to restrict the government's power to legislate for the public welfare. It has scrutinized such action only to ensure that the challenged legislation involved a legitimate exercise of "'the sovereign right of the Government to protect the * * * general welfare of the people.'" *Allied Structural Steel Co.* v. *Spannaus*, 438 U.S. 234, 241 (1978). In contrast, the Court has recognized that this principle does not affect a sovereign's ability to enter into binding financial or debt contracts.

If Section 418 agreements are contracts that must be construed to foreclose the federal government from mandatorily enrolling participating states in the System, they fall squarely within the category of agreements that create no vested rights because they purport to deny the government the authority to take

action essential for the general welfare. And the 1983 amendment plainly involved a legitimate attempt to legislate for the public good: Congress amply documented its conclusion that the withdrawal of state and local government employers from the System would leave many workers with inadequate pension and insurance protection, while providing a windfall to employees whose Social Security rights have vested.

D. Finally, even granting the district court all of its questionable assumptions—that is, even assuming that Section 418 agreements are binding, enforceable contracts of a conventional sort—the court below nevertheless erred in concluding that the 1983 amendment effected a taking in the constitutional sense. The Court has identified three principal considerations that bear on the question whether governmental action that diminishes property rights amounts to a taking: "'the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations.'" *Ruckelshaus* v. *Monsanto Co.*, No. 83-196 (June 26, 1984), slip op. 17.

Here, nothing in the character of the 1983 amendment suggests a taking; to the contrary, courts should be particularly reluctant to find a taking when the challenged government action involves the impairment of a contract. Because state employers retain the principal benefit that led them to enter into Section 418 agreements—participation in the System—the economic impact of the legislation does not rise to the level of a taking. And it is difficult to discern *any* investment-backed expectations on the part of appellees that are frustrated by the 1983 amendment since, as the district court acknowledged (J.S. App. 3a-4a), Congress at all times reserved its authority to enact new provisions including employees

of state and local governments in the System. In these circumstances, the amendment cannot be said to have violated "the dictates of '"justice and fairness."'" *Andrus* v. *Allard*, 444 U.S. 51, 65 (1979) (citations omitted).

ARGUMENT

THE 1983 AMENDMENT DID NOT EFFECT A TAKING WITHIN THE MEANING OF THE FIFTH AMENDMENT

The district court has invalidated legislation remedying an arrangement that was manifestly "inequitable both for the employees who lose coverage [when states or localities withdraw from the Social Security System] and for the vast majority of the nation's workforce who continue to pay into the system." H.R. Rep. 98-25, 98th Cong., 1st Sess. Pt. 1, at 18-19 (1983). The impact of the court's decision is extraordinary. The holding below will have an immediate effect on the 227,000 state and local government employees whose employers attempted to withdraw from the System as of 1984; if their coverage is terminated, a great many of these employees will be left with inadequate pension and insurance guarantees, while others—whose rights in the System already have vested—will obtain windfall payments. Similarly, the decision potentially may affect the pension rights of more than 9 million other state and local government employees, whose participation in Social Security (under the district court's ruling) may be terminated at any time at the election of their employers. The financial impact on the System of the the district court's decision also is immense: if withdrawals are permitted to continue at their current pace, the Social Security trust funds will lose between $500 million and $1 billion annually (H.R.

Comm. Print 97-32, at 13-14), with an aggregate loss of well over $3 billion for the 1983-1989 period. S. Rep. 98-23, 98th Cong., 1st Sess. 2, 13 (1983).

These difficulties, however, are not the inevitable result of some fatal constitutional flaw in the 1983 amendment that was identified by the district court. To the contrary, that court disregarded a range of considerations that should have been at the center of its assessment of the 1983 amendment's constitutionality. The court failed to consider the purpose of the Section 418 program and the nature of the agreements consummated under the Act. It took no account of Congress's preeminent role in arranging "the burdens and benefits of economic life." *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976). And the court gave no weight to the congressional judgment that, because Social Security is "the Nation's basic social insurance program" (H.R. Comm. Print 97-32, at 1), "the Nation as a whole should share in the cost of that program." Senate Special Comm. on Aging, 96th Cong., 2d Sess., *State and Local Government Terminations of Social Security Coverage* 76 (Comm. Print 1980) [hereinafter cited as 1980 Sen. Comm. Print].[15]

A. Section 418 Agreements Do Not Create Vested Property Rights That Are Protected By The Fifth Amendment

The district court grounded its holding on the assumption that Section 418 agreements represent run-of-the-mill contractual relationships between the state

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[15] As we explained in our Jurisdictional Statement (at 9-10 n.9), none of the POSSE plaintiffs was properly before the district court. Because the court concededly did have jurisdiction to resolve California's complaint, however, it had the authority to decide the case.

and federal governments, with each side holding vested property rights. The 1983 amendment, the court reasoned, modified and thus impaired the value of the Section 418 agreement at issue in this case, and in that way effected a "taking" of the property represented by the "contract." The district court's basic assumption, however, involves a fundamental misunderstanding of the nature of Section 418, and of the agreements consummated under its authority.

Section 418 and the agreements that implement it establish the conditions that govern current state participation in the System, and describe the ongoing rights and responsibilities of the state and federal governments. Federal administrative officials—and the officials of participating states—plainly must comply with those conditions, as they must with all elements of federal law. See generally *Bennett* v. *New Jersey*, No. 83-2064 (Mar. 19, 1985), slip op. 6; *Bell* v. *New Jersey*, 461 U.S. 773, 790-791 (1983). But while Section 418 agreements have a "contractual aspect" that may not be repudiated by the Secretary, a cooperative federal-state program such as the one established by Section 418 "cannot be viewed in the same manner as a bilateral contract governing a discrete transaction." *Bennett* v. *Kentucky Department of Education*, No. 83-1798 (Mar. 19, 1985), slip op. 11. The agreements have no life or legal significance of their own; they exist only to implement the Act.

Section 418 agreements thus do not involve arms-length negotiation with each side attempting to obtain the benefit of the bargain, or play the role of contracts that may be said to embody "investment-backed expectations." *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104, 124 (1978). Instead, Congress created the agreement mechanism

simply as a convenient method for "extend[ing] coverage as quickly and with as little difficulty as possible to those [state and local government] employees who needed it most." H.R. Rep. 98-25, *supra*, at 19; see H.R. Comm. Print 97-32, at 5. See generally H.R. Rep. 1300, 81st Cong., 1st Sess. 6 (1949); S. Rep. 1669, 81st Cong., 2d Sess. 6 (1950). In essence, the original version of Section 418 was no different from any statute that establishes a federal program and gives the states an open option to participate.

This is a familiar method of federal regulation; to maintain flexibility and facilitate effective administration, Congress often has invited the states to participate voluntarily in the welfare and disbursement programs that it creates.[16] Such arrangements never have been understood to create enforceable expectations on the part of participants that prevent Congress from making prospective changes in the program. To the contrary, "[u]nlike normal contractual undertakings," programs of this sort "originate in and remain governed by statutory provisions expressing the judgment of Congress concerning desirable public policy." *Kentucky Department of Education*, slip op. 12. Section 418 thus effectuates "a regulatory policy," rather than "a contractual arrangement." *National Railroad Passenger Corp.* v. *Atchison, T. & S.F. Ry.*, No. 83-1492 (Mar. 18, 1985), slip op. 14. And when Congress establishes such a legislative program, "the presumption is that '[it] is not intended

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[16] See, *e.g.*, 7 U.S.C. 2011-2029 (Food Stamp Act of 1977); 20 U.S.C. 2701 *et seq.* (Elementary and Secondary Education Act of 1965); 49 U.S.C. App. 1601a, 1602-1605, 1608, 1610-1612 (Urban Mass Transportation Assistance Act of 1970).

to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.'" *Ibid.* (quoting *Dodge* v. *Board of Education*, 302 U.S. 74, 79 (1937)). See *Rector of Christ Church* v. *County of Philadelphia*, 65 U.S. (24 How.) 300, 302 (1861).

That Congress did not intend to create contractual rights here is confirmed both by the legislative history and by the structure of the Act. While Section 418 in its original form offered the states an opportunity to withdraw from the System, "[t]he termination provision receive[d] little attention in the legislative histories of amendments since 1939, presumably because it was assumed that once covered, few groups would seek to terminate coverage." H.R. Comm. Print 97-32, at 3. See generally H.R. Rep. 1300, *supra*, at 6, 10-11; S. Rep. 1669, *supra*, at 6, 10, 13-14; H.R. Conf. Rep. 2771, 81st Cong., 2d Sess. 100 (1950). The congressional emphasis, instead, was on the voluntary nature of the state's *initial* decision to participate in the System. See, *e.g.*, S. Rep. 1669, *supra*, at 10. In contrast, Congress nowhere indicated that it intended to freeze the relationship between the federal government and participating states.

Moreover, "lest there be any doubt in this case about Congress' will" (*National Railroad Passenger Corp.*, slip op. 16), the statute from the outset expressly has reserved to Congress "[t]he right to alter, amend, or repeal any provision of [the Act]." 42 U.S.C. 1304. For over a century, the Court has "recognized the effect of these few simple words" (*National Railroad Passenger Corp.*, slip op. 16 n.22): "through the language of reservation 'Congress not only retains, but has given special notice of its intention to retain, full and complete power to make such alterations and amendments * * * as come within the just scope of legislative power.'" *Ibid.* (quoting the *Sinking-Fund Cases*, 99 U.S. 700, 720 (1879)). Congress hardly can have intended legislation containing such a provision to give rise to static property interests.

It is true, of course, that the Section 418 program makes use of written agreements, a consideration that the district court evidently found determinative (see J.S. App. 30a-32a). But there is no talismanic significance to the existence of a separate writing signed by a representative of the federal government. Congress provided that the states could join the Social Security System by means of individual agreements in an attempt to permit them to play a continued role in the provision of retirement and disability benefits to state and local employees; states may enroll certain coverage groups so as to preserve their existing pension systems, and may include in their agreements any provisions that are not inconsistent with the Act. See H.R. Comm. Print 97-32, at 20. Written Section 418 agreements obviously are necessary to memorialize these arrangements.[17] It would turn this cooperative aim on its head, however —and ultimately would disserve state interests—to conclude that attempts to accommodate the states in

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[17] Federal grant programs invariably make use of written plans that describe the terms of state participation. See, *e.g.*, 7 U.S.C. 2020(d) and (e) (Food Stamp program); 42 U.S.C. 1396 and 1396a (Medicaid program). It has never been understood that the states, by filing such plans with the federal government, accept an "offer" to enter into a contract, and in that way foreclose Congress from making prospective changes in the programs involved.

federal regulatory programs give rise to contractual relationships that make changes in those programs impermissible. Cf. *FERC* v. *Mississippi*, 456 U.S. 742, 765 n.29 (1982).

Indeed, viewed in context there can be little doubt that the termination provision in California's Section 418 agreement has no independent legal significance. That provision was not separately negotiated by the State; it simply echoed—and added nothing to—the termination rights granted by the pre-1983 version of Section 418(g). Not surprisingly, then, nothing in the agreement suggests that its termination provision was intended to do more than restate the controlling terms of the statute, or was designed to survive a legislative change in those terms.

In any event, Section 418 agreements have none of the indicia of typical contracts. Their purpose is not a parochial one related to the self-interest of the parties. Nor do the parties venture their property in exchange for a reciprocal undertaking respecting that property. Instead, the agreements make available to individual workers the benefits of participation in a generally applicable social welfare program. The implementation of the agreements is subject to regulations promulgated by the Secretary. 42 U.S.C. 418(i). And the Act makes provision for administrative and judicial review of challenges to assessments and payments (42 U.S.C. 418(s) and (t)) in a manner that parallels those applicable to most federal programs.

In short, the 1983 amendment involved a recasting of the legislation defining the System—that is, of the "statutory provisions expressing the judgment of Congress concerning desirable public policy." This is not a case where the Secretary refused to administer the Section 418 program along the lines mandated by

Congress; instead, Congress used the 1983 amendment to modify the terms on which the Section 418 program will be administered in the future. So long as it had the substantive constitutional authority to enact the 1983 amendment, there was nothing illegitimate in Congress's decision to take prospective action of that sort.

B. Congress Did Not Surrender Its Authority To Make Changes In The Social Security System Through Legislation

Despite the programmatic nature of Section 418, the district court held that Congress may not enact legislation bearing directly on Section 418 agreements, just as a party to a private commercial contract generally may not make unilateral changes to its contractual obligations. In reaching this conclusion, the district court evidently reasoned that Congress, no more than the Secretary or any other administrative official, may change the obligations of participating states in the absence of extra-contractual legislation modifying the System as a whole. As we demonstrated above, this analysis is flawed. But even on its own terms, the district court's reasoning is unpersuasive. On close examination, it becomes clear that the 1983 amendment did not in fact deprive appellees of any rights vested by California's Section 418 agreement: even if the district court was correct in concluding that Section 418 agreements create a contractual relationship between participating states and the Secretary, it hardly follows that the federal government, by entering into such agreements, meant to bind itself never to enroll state employees in the System mandatorily, or never to modify either Section 418 or the System in a manner

that changes the relationship between state employers and the federal government.

1. Even considering this case solely within the confines of the Section 418 agreement, appellees' claims of breach of contract lack merit. The agreement at issue here was, of course, written to effectuate Section 418: the document recites that the Federal Security Administrator (the Secretary's predecessor) entered into the agreement under the authority of Section 418, and declares that the agreement is intended to extend the protections of Social Security to various state employees "in conformity with" Section 418 (J.A. 29). And Section 418(a)(1) itself—which under the agreement's own terms is controlling—flatly provides that federal-state agreements may not contain provisions that are "inconsistent with the provisions of this section." Because the termination provision of California's Section 418 agreement is now inconsistent with the amended Section 418, that provision is unenforceable.

In recognizing that agreements may not contain provisions that are inconsistent with Section 418, the parties to California's agreement plainly intended to preclude "contractual" terms that conflict with amendments to the statute, as well as terms that are inconsistent with the statute as it was enacted in 1950. The agreement nowhere indicates that it will "conform[]" only with pre-existing law. Similarly, the statute does not suggest that it was meant to invalidate only provisions of agreements that are "inconsistent" with the terms of Section 418 as it was originally enacted. And it is impossible to believe that Congress meant to bind itself never to depart from the terms of the Section 418 program as they were established in 1950. Section 418 directs the

Secretary to include in his agreements all provisions proposed by the states that are not inconsistent with the statute (42 U.S.C. 418(a)(1) and (c)(4)); if Congress gave participating states the right either to leave the System or to remain indefinitely on their own terms, while denying itself the opportunity to modify state responsibilities in any way (or, presumably, the right to terminate state participation in the System), it "would have struck a profoundly inequitable bargain." *National Railroad Passenger Corp.*, slip op. 16.[18]

This reading of the agreement is supported as well by venerable principles of contract construction. It is black letter law that contracts must be deemed to incorporate the terms of relevant statutes. See, *e.g.*, *United States* v. *Erika, Inc.*, 456 U.S. 201, 211 n.14 (1982). Indeed, "not only [is] existing law[] read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into [the] contract[] as a postulate of the legal order." *Home Building & Loan Ass'n* v. *Blaisdell*, 290 U.S. 398, 435 (1934).

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[18] For example, Section 418 describes the coverage groups that may join the System, as well the special conditions pursuant to which some of them will be admitted (*e.g.*, 42 U.S.C. 418(c), (d) and (u)); it is hardly likely that Congress meant to foreclose itself from ever legislating to exclude certain of these groups from Social Security, or from imposing additional conditions (such as, perhaps, a requirement of referenda among affected employees) prior to the state's decision to terminate coverage. Similarly, it would have been extraordinary had Congress intended to deny itself the opportunity to modify such matters as the terms on which administrative or judicial review will be available (see 42 U.S.C. 418(s) and (t)) or the penalties for late payment (see 42 U.S.C. 418(j)). Cf. *Bell* v. *New Jersey*, 461 U.S. at 777-778 n.3.

Cf. *United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 19-20 n.17 (1977). Here, that existing law includes 42 U.S.C. 1304, which, as noted above, expressly reserves Congress's right to alter or amend any provision of the Act. The parties to the agreement accordingly must be deemed to have recognized that Congress was empowered to amend Section 418 —an action that necessarily would affect the validity of the relevant provisions of existing agreements. Because the agreement at issue thus itself acknowledged Congress's authority to modify Section 418, the 1983 amendment disturbed no settled rights.

2. a. The district court's holding also cannot be squared with this Court's usual approach to claims that contracts foreclose the legislature's right to modify its social programs. The Court has explained that "sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction." *Merrion* v. *Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982). It has thus repeatedly held that "[c]ontractual arrangements remain subject to subsequent legislation by the presiding sovereign * * * unless [the sovereign's ability to enact such legislation] 'has been specifically surrendered in terms which admit of no other reasonable interpretation.'" *Jicarilla Apache Tribe*, 455 U.S. at 147-148 (quoting *City of St. Louis* v. *United Rys.*, 210 U.S. 266, 280 (1908)).[19] See, *e.g.*, *United States*

[19] In *Jicarilla Apache Tribe*, for example, the Tribe entered into contractual arrangements with private parties, granting them rights to oil and natural gas in tribal land in exchange for a specified fee. See 455 U.S. at 135; *id.* at 186 (Stevens, J., dissenting). The Tribe subsequently imposed a severance tax on oil and natural gas removed from tribal land. In response to an argument that the tax violated the contractual arrangement by imposing additional requirements not spelled out in the oil and gas leases, the Court held that the Tribe had not contracted away its sovereign right to levy the tax, refusing to find that "the Tribe has abandoned its sovereign powers simply because it has not expressly reserved them through a contract" (*id.* at 146); "[t]o presume that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in a commercial agreement turns the concept of sovereignty on its head." *Id.* at 148.

Trust Co. v. *New Jersey*, 431 U.S. 1, 25 (1977); *New York Rapid Transit Corp.* v. *City of New York*, 303 U.S. 573, 590-593 (1938); *Puget Sound Power & Light Co.* v. *Seattle*, 291 U.S. 619, 627 (1934); *Providence Bank* v. *Billings*, 29 U.S. (4 Pet.) 514, 562 (1830). Cf. *Thorpe* v. *Housing Authority*, 393 U.S. 268, 279 (1969) (a federal agency may impose upon a party with whom it has a contract "an additional obligation not contained in the contract" when "that obligation is imposed under [the agency's] wholly independent rule-making power"); *Horowitz* v. *United States*, 267 U.S. 458, 461 (1925) ("the United States when sued as a contractor cannot be held liable for an obstruction to the performance of a particular contract resulting from its public and general acts as a sovereign"). And this is more than a convenient principle of construction: it serves to avoid the troublesome constitutional and public policy questions posed when "one legislature, by [a] contract with an individual, * * * restrain[s] the power of a subsequent legislature to legislate for the public welfare." *Boyd* v. *Alabama*, 94 U.S. 645, 650 (1876). See *United States Trust*, 431 U.S. at 45 (Brennan, J., dissenting).

Yet there is absolutely nothing in the Section 418 agreement at issue here (or, to our knowledge, in any

other Section 418 agreement) that purports to insulate appellees (or any participating state) from the effects of legislative changes in the Social Security System. The document simply describes the employees who have been enrolled in the System (J.A. 30, 34-35, 38, 39, 41, 42), and lists the rights and obligations of the State *under the agreement* (J.A. 30-32, 35-36). Thus, while it provides that the State "may terminate this agreement" (J.A. 31), the document upon which the district court's opinion rests nowhere guarantees—or even suggests—that Congress will not enact supervening legislation that would obviate the agreement altogether by requiring the states to participate in Social Security. Indeed, nothing in Section 418 itself authorizes the Secretary to enter into agreements that contain such undertakings.[20]

The structure of the Act, moreover, again confirms that Congress did not intend to "nonchalantly shed [the] vitally important governmental power" (*National Railroad Passenger Corp.*, slip op. 17) to modify essential elements of the Social Security System—and that participating states could not reasonably have believed that Congress meant to enter into such a bargain. As noted above, the Act contains an express reservation of congressional authority to modify any

[20] Conversely, neither Section 418 nor any individual agreements contain a provision permitting the United States to terminate the Social Security coverage of state and local government employees. See note 9, *supra*. Yet if Congress were to eliminate the System altogether, it is difficult to imagine that the federal government would be obligated by the existing agreements to continue paying Social Security benefits to those (and only to those) employees. This obviously suggests that the agreements were not intended to address Congress's authority to enact legislation affecting state participants in the System.

of the Act's provisions. And this Court repeatedly has noted that the survival of the System requires

> flexibility and boldness in adjustment to ever-changing conditions * * *. It was doubtless out of an awareness of the need for such flexibility that Congress included in the original Act, and has since retained, a clause expressly reserving to it '[t]he right to alter, amend, or repeal any provision' of the Act. * * * That provision makes express what is implicit in the institutional needs of the program.

Flemming v. *Nestor*, 363 U.S. 603, 610-611 (1960). Cf. *United States Railroad Retirement Board* v. *Fritz*, 449 U.S. 166, 174 (1980); *Hisquierdo* v. *Hisquierdo*, 439 U.S. 572, 575 (1979); *Richardson* v. *Belcher*, 404 U.S. 78, 80-81 (1971). It is hardly likely, then, that Congress would have "abandoned its sovereign powers" (*Jicarilla Apache Tribe*, 455 U.S. at 146) to adjust, through legislation, the Social Security obligations of state and local employers.

b. Against this background, it is beyond dispute that "the United States possesses general regulatory power over appellee outside the contractual relationship." *FHA* v. *The Darlington, Inc.*, 358 U.S. 84, 98 (1958) (Harlan, J., dissenting). In exercising this power—as the district court itself evidently recognized (J.S. App. 3a-4a)—Congress could have ignored the outstanding agreements and simply enacted new legislation permanently bringing into the Social Security System those state and local government employees who already are covered.[21] And if Congress re-

[21] Indeed, Congress took just this approach in extending mandatory coverage to *all* employees of nonprofit organizations, whether or not those organizations previously had

tained the authority to take such action, it seems absurd to suggest that the 1983 amendment is constitutionally suspect because Congress achieved the same result by modifying Section 418.

The Court has applied precisely this reasoning in rejecting other formalistic challenges to federal welfare legislation. In *Turner Elkhorn Mining*, for example, the statute at issue provided that coal miners

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participated in the System voluntarily. See note 10, *supra*. In modifying Section 418(g), Congress attempted to accommodate the states by using the somewhat more limited approach of making participation in the System mandatory only for state and local government workers who already are covered. We note that Congress plainly acted rationally in distinguishing between state and local government employees who currently are participants in the System and those who are not. Expanding coverage to workers outside of Social Security would mean displacing existing pension systems (H.R. Comm. Print 97-32, at 18), and would impose double burdens on states or localities that currently operate "pay-as-you-go" pension plans. S. Rep. 98-13, 98th Cong., 1st Sess. 100 (1983). Similarly, persons brought into the System by the states voluntarily were, as a general matter, the ones most in need of Social Security coverage. See H.R. Rep. 98-25, *supra*, at 19; H.R. Comm. Print 97-32, at 5. And the rights of employees currently making Social Security payments may have vested; permitting them to withdraw may entitle them to benefits even though they no longer are paying a portion of their wages into the System. H.R. Rep. 98-25, *supra*, at 19; pages 40-41, *infra*. Congress thus has a compelling interest in preventing movement in and out of the System. See *RoAne* v. *Mathews*, 476 F. Supp. 1089, 1100 (N.D. Cal. 1977), aff'd, 604 F.2d 37 (9th Cir. 1979). See generally *The Darlington*, 358 U.S. at 91 (citation omitted) ("'[f]ederal regulation of future action based upon rights previously acquired by the person regulated is not prohibited by the Constitution'"); *Heckler* v. *Mathews*, 465 U.S. 728, 748 (1984); *Califano* v. *Webster*, 430 U.S. 313, 321 (1977); *United States* v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4, 6 (1970).

afflicted with complicated pneumoconiosis were "irrebuttably presumed" to be totally disabled, and therefore entitled to be compensated by their employers. 428 U.S. at 10-11. The employers challenged the constitutionality of this provision, asserting that its use of an irrebuttable presumption violated their due process rights. *Id.* at 23. The Court, however, noted that Congress could have awarded compensation to afflicted miners simply because their health had been impaired, whether or not they were in fact totally disabled. In these circumstances, the Court explained, "the argument is essentially that Congress has accomplished its result in an impermissible manner * * *. But in a statute such as this, regulating purely economic matters, we do not think that Congress' choice of statutory language can invalidate the enactment when its operation and effect are clearly permissible." *Id.* at 23-24.

Here, as the district court seemingly acknowledged (J.S. App. 3a-4a), the purpose and effect of the 1983 amendment—guaranteeing permanent Social Security coverage for state and local government employees who already are participants in the System—was a self-evidently permissible one. See note 21, *supra*. And the legislative history indicates that Congress believed that it was, "[a]s an operational matter" (*Turner Elkhorn Mining*, 428 U.S. at 22), exercising its regulatory authority to modify the Social Security System when it amended Section 418(g). Congress made no reference to the abrogation of contractual rights; instead, it declared flatly that it was "prohibit[ing] State and local governments from terminating [Social Security] coverage for their employees." H.R. Rep. 98-25, *supra*, at 19; S. Rep. 98-23, *supra*, at 5. See S. Rep. 98-13, 98th Cong., 1st Sess. 99-100

(1983). That Congress found it most efficacious to take this step by making existing agreements nonterminable, rather than by, in terms, expanding the mandatory coverage of the System, cannot have independent constitutional significance: " 'The Constitution is "intended to preserve practical and substantial rights, not to maintain theories." ' " *City of El Paso* v. *Simmons*, 379 U.S. 497, 515 (1965) (citations omitted).[22]

C. Congress Could Not Surrender Its Sovereign Authority To Modify The Social Security System

The district court concluded that its inquiry was at an end once it determined that Section 418 agreements are contracts. That conclusion, as the discussion above explains, disregarded this Court's views on the propriety of substituting semanticism for constitutional analysis. If the court below meant to hold that Section 418 agreements must be construed in a way that would prevent Congress from making essential modifications in the Social Security System, however, its decision is flawed for another reason: such a holding cannot be reconciled with this Court's repeated admonition that federal and state "governmental powers cannot be contracted away." *North American Commercial Co.* v. *United States*, 171 U.S. 110, 137 (1898).

1. From the earliest days of the Republic, the Court has made it plain that the property clauses of the Constitution—the Taking, Due Process, and Con-

[22] While Congress presumably could cure the semantic defect identified by the district court through the enactment of a new statute making state participation in the System mandatory, in the interim several hundred thousand state and local government employees would have lost their Social Security coverage.

tract Clauses—do not require the federal or state governments "to adhere to * * * contract[s] that surrender[] an essential attribute of [their] sovereignty." *United States Trust*, 431 U.S. at 23. See *id.* at 46-49 (Brennan, J., dissenting).[23] Thus, "the exercise of the police power cannot be limited by contract for reasons of public policy * * * and it is immaterial upon what consideration the contracts rest, as it is beyond the authority of the State * * * to abrogate this power so necessary to the public safety." *Northern P. Ry.* v. *Minnesota ex rel. Duluth*, 208 U.S. 583, 598 (1908). See *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 108-109 (1938). This principle serves a compelling purpose:

> One of the fundamental premises of our popular democracy is that each generation of representatives can and will remain responsive to the needs and desires of those whom they represent. Crucial to this end is the assurance that new legislators will not automatically be bound by the policies and undertakings of earlier days.

United States Trust, 431 U.S. at 45 (Brennan, J., dissenting).

Against this background, the Court repeatedly has rejected challenges to legislative action impairing or abrogating contractual obligations that purported to restrict the government's right to legislate for the public welfare. See, *e.g.*, *Simmons*, 379 U.S. at 508; *Pierce Oil Corp.* v. *City of Hope*, 248 U.S. 498, 501

[23] The Court offered an example of the application of this doctrine in *United States Trust*: "a revenue bond might be secured by the State's promise to continue operating the facility in question; yet such a promise surely could not validly be construed to bind the State never to close the facility for health or safety reasons." 431 U.S. at 25. See *id.* at 23 n.20.

(1919); *Northern P. Ry.*, 208 U.S. at 597; *New Orleans Gas Light Co.* v. *Drainage Comm'n*, 197 U.S. 453, 460 (1905); *Chicago B. & Q. R.R.* v. *Nebraska ex rel. Omaha*, 170 U.S. 57, 72 (1898); *Butchers' Union Co.* v. *Crescent City Corp.*, 111 U.S. 746, 751 (1884); *Stone* v. *Mississippi*, 101 U.S. 814, 817 (1880); *Beer Co.* v. *Missachusetts*, 97 U.S. 25, 33 (1877). See *United States Trust*, 431 U.S. at 23 n.20. Cf. *Horowitz*, 267 U.S. at 461; *Pennsylvania Hospital* v. *City of Philadelphia*, 245 U.S. 20, 23-24 (1917); *Goszler* v. *Georgetown*, 19 U.S. (6 Wheat.) 593, 597-598 (1821).[24] The Court has scrutinized such action

[24] Many of these cases involved challenges to state legislation brought under the Contract Clause, which does not apply to the federal government. See *Pension Benefit Guarantee Corp.* v. *R.A. Gray & Co.*, No. 43-245 (June 18, 1984), slip op. 14 n.8. But these decisions have force outside the Contract Clause context; the Court has made it clear that legislation enacted for the general welfare that impairs a state's contractual obligations should not be deemed to violate any "property rights protected by the Federal Constitution." *Northern P. Ry.*, 208 U.S. at 597. In any event, the Court repeatedly has suggested that the Contract Clause imposes more rigorous restrictions upon the states than the Fifth Amendment imposes on the federal government (*Gray*, slip op. 15; *National Railroad Passenger Corp.*, slip op. 21 n.25). It follows *a fortiori* that, if the Contract Clause does not require the states to adhere to contracts that surrender essential attributes of their sovereignty, the Fifth Amendment does not impose such an obligation on the United States. See notes 31, 32, *infra* (addressing the relationship between the Fifth Amendment's Taking and Due Process Clauses).

It should be added that a government's right to exercise its eminent domain powers to take a contract that is frustrating its current policies (see *United States Trust*, 431 U.S. at 19 n.16) does not suffice to preserve the government's sovereign prerogatives. As a practical matter, the substantial value of many contracts may effectively foreclose the use of eminent do-

only to ensure that the challenged legislation involved a legitimate exercise of " 'the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people' " (*Allied Structural Steel Co.* v. *Spannaus*, 438 U.S. 234, 241 (1978) (citation omitted)), rather than the bald "repudiation" of a contractual obligation. *Lynch* v. *United States*, 292 U.S. 571, 580 (1934). Cf. *id.* at 579 (legislation abrogating the government's contractual obligations is not inconsistent with the Fifth Amendment when "the action taken falls within the federal police power or some other paramount power"); *Simmons*, 379 U.S. at 509 (Contract Clause prevents states from adopting the repudiation of debts as a policy).[25]

main—a circumstance that would permit one legislature to establish policy that cannot realistically be modified in the future if subsequent legislatures must regulate by purchasing outstanding contracts. Cf. *id.* at 29 n.27. And none of the Court's decisions in this area suggests that persons challenging legislation that impairs state contracts may have a valid taking claim. Compare *Simmons*, 379 U.S. at 516-517, with *id.* at 533-534 (Black, J., dissenting). Cf. *Pennsylvania Hospital*, 245 U.S. at 22-23. In any event, because the Court has reasoned that contracts purporting to bind a state not to exercise its police powers are m[illegible] subject to an implied condition that the contracts may be frustrated (see *Brand*, 303 U.S. at 108-109), such contracts do not create property to be taken—a conclusion that seems to follow from this Court's oft-stated view that the power to exercise eminent domain cannot be contracted away. See *Pennsylvania Hospital*, 245 U.S. at 22-23.

[25] This principle only comes into play, of course, when *legislative* actions modifying contractual obligations are challenged. It obviously does not give executive officials license to repudiate authorized contractual undertakings.

On the other hand, the Court has recognized that this principle does not affect a sovereign's authority to enter into binding financial or "debt contracts." *United States Trust*, 431 U.S. at 24. See *id.* at 24-25 n.22 (citing cases). See generally *United States* v. *Standard Rice Co.*, 323 U.S. 106, 111 (1944). The Court has explained that such agreements—which establish the government's "contractual obligations when it enters financial or other markets" (*Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 412-413 n.14 (1983))—do not involve "a compromise of the State's reserved powers." *United States Trust*, 431 U.S. at 25.[26] The Court accordingly has treated contracts of this sort as binding ones that create property protected by the Fifth Amendment. *Lynch*, 292 U.S. at 579.[27]

The cases in which the Court has invalidated congressional legislation that abrogated contracts to which the federal government was a party fall squarely within this second category. In *Lynch*, for example, the

[26] " 'The truth is, States and cities, when they borrow money and contract to repay it with interest, are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons.' " *United States Trust*, 431 U.S. at 25 n.23 (citation omitted).

[27] In the Contract Clause context, the Court has explained that even commercial contracts may be impaired if the state action "is reasonable and necessary to serve an important public purpose." *United States Trust*, 431 U.S. at 25. Because the "State's self-interest is at stake" (*id.* at 26) when contracts of this sort are repudiated, however, the Court has declined to defer absolutely to the government's assessment that abrogation is in the public interest. See *National Railroad Passenger Corp.*, slip op. 20 n.24; *Energy Reserves Group*, 459 U.S. at 412-413 n.14.

Court invoked the Taking and Due Process Clauses in striking down legislation that effectively repudiated the government's obligation to pay claims on its war risk insurance policies. 292 U.S. at 579. While these policies were not issued for profit (*id.* at 576), they plainly were quasi-commercial undertakings that in no way restricted the power of Congress to legislate for the general welfare. Indeed, the Court explained that there was no suggestion in *Lynch* that Congress "abrogate[d] these contracts in the exercise of the police or any other power." *Id.* at 580. Instead, the Court concluded that the legislation had been motivated by a simple intent to maintain the government's credit by reducing its obligations, and held that "[p]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." *Ibid.* In reaching this conclusion, the Court took pains to note that federal contracts *may* be abrogated when "the action taken falls within the federal police power or some other paramount power." *Id.* at 579 (footnote omitted). As the Court has subsequently explained, *Lynch* thus stands only for the proposition that "need for money is no excuse for repudiating contractual obligations." *United States Trust*, 431 U.S. at 26 n.25. See *National Railroad Passenger Corp.*, slip op. 20 n.24 (characterizing *Lynch* as subjecting the contractual abrogation to special scrutiny because it involved an attempt to "maintain the credit of public debtors").[28]

[28] *Perry* v. *United States*, 294 U.S. 330 (1935), one of the *Gold Clause Cases*, was decided on even narrower grounds. That case involved a challenge to legislation authorizing the redemption of United States gold bonds in legal tender currency rather than in gold dollars. See *id.* at 347. The Court held that the legislation could not be squared with Art. I, § 8,

2. If Section 418 agreements are contracts that must be construed to foreclose the federal government from mandatorily enrolling participating states in the System, they plainly fall within the first category of contracts outlined above—those that create no vested rights because they purport to deny the government the authority to take action essential to the general welfare. Section 418 agreements are not "purely financial" arrangements like revenue bonds (*United States Trust*, 431 U.S. at 25). Instead, they are the mechanism that Congress used to provide welfare and insurance protection to millions of workers. If the agreements disable Congress from legislating in this area, and thus from protecting a large portion of the workforce against "the risks and uncertainties of advanced industrial society" (H.R. Comm. Print 97-32, at 7), they plainly surrender—impermissibly—an essential attribute of federal sovereignty.

The remaining question is whether the 1983 amendment involved a bona fide attempt to legislate for the general welfare. That issue is easily resolved: even a glance at the legislative history demonstrates that the purposes of the 1983 amendment transcended the sort of repudiation of commercial obligations that was at issue in *Lynch*. Ten years ago, Congress already was expressing concern that the withdrawal of

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Cl. 2 of the Constitution, which authorizes Congress to "borrow money on the credit of the United States"; if Congress could repudiate its bond obligations, the Court held, "the credit of the United States [would be] an illusory pledge" (294 U.S. at 350). See also *id.* at 353-354 (citing Amend. 14 § 4 ("The validity of the public debt of the United States * * * shall not be questioned")). The holding in *Perry* therefore cannot be applied outside its specific context. See generally 294 U.S. at 361 (Stone, J., concurring); *United States Trust*, 431 U.S. at 26 n.25.

local government employees from the System would "reduce the employees' overall benefit protection and lead to increased dependency on others in the future." Senate Special Comm. on Aging, 94th Cong., 2d Sess., *Termination of Social Security Coverage: The Impact on State and Local Government Employees* 2 (Comm. Print 1976) [hereinafter cited as 1976 Sen. Comm. Print]. Since then, Congress has noted repeated suggestions that participation in the System be made mandatory for employees already covered by Section 418 agreements. 1976 Sen. Comm. Print 32; 1980 Sen. Comm. Print 78. In finally making that change, Congress enacted into law a recommendation of the bipartisan National Commission on Social Security Reform. See S. Rep. 98-13, *supra*, at 88-89, 104.

The 1983 amendment was designed to protect the interests of state and local government employees while preserving public confidence in the System as a whole. Congress noted that local government employers were withdrawing from the System "in significant numbers * * * for reasons that appear to have more to do with reducing operating costs than providing basic, adequate protection for all employees." H.R. Rep. 98-25, *supra*, at 19. See H.R. Comm. Print 97-32, at 12-13, 15, 16; 1980 Sen. Comm. Print 17. Local retirement and insurance systems created to replace Social Security could not, in the congressional judgment, duplicate the features of Social Security that Congress deemed essential: the System covers virtually all risks, and provides a cushion for periods of unemployment or employment at low wages. See H.R. Comm. Print 97-32, at 12; 1980 Sen. Comm. Print 24-25, 72-73, 81. This circumstance created particular difficulties for employees

whose coverage had not vested at the time of termination, or who change jobs frequently. Because only Social Security offers retirement protection that is fully "portable" from job to job, such employees might never obtain Social Security benefits, despite having made payments into the System, and would likely be left with inadequate pension and insurance guarantees. See H.R. Rep. 98-25, *supra*, at 19; S. Rep. 98-13, *supra*, at 99; H.R. Comm. Print 97-32, at 12-13; 1980 Sen. Comm. Print 46; 1976 Sen. Comm. Print 24.[29]

Conversely, Congress found that termination of coverage provided a windfall to employees whose Social Security rights already had vested: they remained eligible for substantial benefits although they no longer made payments into the System. H.R. Rep. 98-25, *supra*, at 19; S. Rep. 98-13, *supra*, at 99; H.R. Comm. Print 97-32, at 6, 9-10, 15; 1980 Sen. Comm. Print 74.[30] This plainly inequitable situation led

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[29] Congress explained that "[t]he employer may view the worker who leaves after a relatively short time as a marginal employee for whom he has little interest in providing attractive pension benefits. Consistent with this view, most State government retirement systems are designed to best serve long-term employees. Yet from the point of view of social policy, the employee who moves from job to job needs basic social insurance protection as much as a worker who stays at one job his entire career. The interests of the employer who wishes to retain career employees with a good benefit package may not be consistent with overall social policy, or with the interests of all his employees, both present and future." H.R. Rep. 98-25, *supra*, at 19.

[30] Employees who participate in the System for a set period obtain a lifetime entitlement to retirement and medical benefits (although entitlement to disability benefits terminates five years after the employee withdraws from the System). See

to considerable resentment on the part of workers whose participation in the System was mandatory, and who found themselves inheriting the tax burden surrendered by employees whose rights in the System had vested. H.R. Rep. 98-25, *supra*, at 19; H.R. Comm. Print 97-32, at 14. And it bolstered Congress's conclusion that the "voluntary coverage provision can be seen as an anomaly in the context of a basically mandatory system." H.R. Rep. 98-25, *supra*, at 19. See generally S. Rep. 98-13, *supra*, at 90-91; H.R. Comm. Print 97-32, at 4-5. Congress's attempt to remedy that anomaly in the Nation's basic insurance system plainly involved a legitimate exercise of "the federal police power or some other paramount power." *Lynch*, 292 U.S. at 579. See generally *United States* v. *Lee*, 455 U.S. 252, 258-259 (1982).

1980 Sen. Comm. Print 4-5. While retirement benefits are pegged to an average of career earnings in the System, the formula "is unable to distinguish between an individual with a short period of high earnings, and an individual with a long period of low earnings." S. Rep. 98-13, *supra*, at 102. The System thus treats an employee who participated in Social Security for only part of his career as though he had participated in the System for a lifetime at low wages. And because the Social Security benefit formula is weighted towards persons with low incomes, an employee who is enrolled in Social Security for only part of his career obtains an advantage: the Social Security benefit he receives replaces a relatively high percentage of his covered earnings, while he pays no Social Security tax at all on his uncovered earnings. See *id.* at 102-103. Moreover, Medicare and spousal benefits are not wage-related, and therefore are fully vested once an employee has been covered for the minimum period. H.R. Comm. Print 97-32, at 9-10.

D. Even If Section 418 Agreements Are Property, The 1983 Amendment Did Not Effect A Taking Within The Meaning Of The Fifth Amendment

The preceding sections of this brief demonstrate that the district court erred in concluding that Section 418 agreements are property that was taken by Congress when it enacted the 1983 amendment. But even granting the district court that point—that is, even if Section 418 agreements are enforceable contracts of a conventional sort—the court below nevertheless erred by disregarding this Court's decisions on the validity of laws that affect pre-existing contractual obligations. Such contracts may well be property that is entitled to constitutional protection. The district court failed to recognize, however, that not all "impairment[s]" of contracts are "of constitutional dimension." *National Railroad Passenger Corp.*, slip op. 20. The impairment here (if one exists) plainly is not.

The Court has indicated that contracts are property within the meaning of the Taking Clause of the Fifth Amendment. See *United States Trust*, 431 U.S. at 19 n.16; *Thorpe* v. *Housing Authority*, 393 U.S. 268, 278 n.31 (1969); *Lynch*, 292 U.S. at 579. Cf. *Ruckelshaus* v. *Monsanto Co.*, No. 83-196 (June 26, 1984), slip op. 12-15. But as the Court repeatedly has noted, "government regulation—by definition—involves the adjustment of rights for the public good." *Andrus* v. *Allard*, 444 U.S. 51, 65 (1979). Thus, at least "where an owner possesses a full 'bundle' of property rights, the destruction of one 'strand' of the bundle is not a taking, because the aggregate must be viewed in its entirety." *Id.* at 65-66. See *Penn Central*, 438 U.S. at 124, 130, 136-138. While the Court has set no fixed formula to determine when regulation crosses the permissible line and effects a taking, it has identified three principal considerations that bear on the question: " 'the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations.' " *Monsanto*, slip op. 17 (quoting *PruneYard Shopping Center* v. *Robbins*, 447 U.S. 74, 83 (1980)). See *Penn Central*, 438 U.S. at 124.

Here, nothing in the character of the legislation suggests a taking. To the contrary, there are special reasons for courts to be particularly concerned about finding a taking where the property affected by the challenged government action is a contract.[31] Contracts allocate future rights and responsibilities between private—or, as here, public—entities. Subjecting legislation affecting such rights to excessive scrutiny might "effectively compel the government to regulate by *purchase*" (*Allard*, 444 U.S. at 65 (emphasis in original)), and thus preclude Congress from playing its role of "adjusting the benefits and burdens of economic life." *Penn Central*, 438 U.S. at 124. And it would permit persons to "remove their transactions from the reach of dominant constitutional power by making contracts about them." *Norman* v. *Baltimore & O. R.R.*, 294 U.S. 240, 308 (1935). See *Legal Tender Cases*, 79 U.S. (12 Wall.)

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[31] The Court has made it plain that a physical invasion is the paradigm of a taking. See, *e.g.*, *Loretto* v. *Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426-427 (1982). Indeed, to our knowledge, the Court has never held that federal legislation effected a taking of a contract right. Although the Court in *Lynch* identified the contracts at issue as property within the meaning of the Taking Clause, it evidently found the challenged legislation improper under the Due Process Clause. 292 U.S. at 579. We note that a taking claim in the contract context currently is before the Court in *Connolly* v. *Pension Benefit Guaranty Corp.*, No. 84-1555.

457, 549-552 (1870). Cf. *United States* v. *Security Industrial Bank*, 459 U.S. 70, 75 (1982).[32]

At the same time, the economic effect of the challenged legislation is not so great as to amount to a taking. Cf. *Thorpe*, 393 U.S. at 278-280 & n.35. State employers retain the principal benefit that led them to enter into Section 418 agreements—participation in the Social Security System. Nothing in the 1983 amendment changed the nature of the ongoing relationship between employers and the federal government. And while termination no longer is possible, it is far from clear that the ability to withdraw from the System was, at any point, a significant part of the attraction of the Section 418 program. To the contrary, as we explain above (at 20), the termination provision received little attention when the Section 418 program was created, presumably because it was assumed that few groups would seek to terminate coverage. Indeed, in the program's first 13 years only four local government entities, representing a total of 48 employees, withdrew from the System (H.R. Comm. Print 97-32, at 26); only one state (Alaska) ever has withdrawn its own employees from the System (see *id.* at 1); and the states have made no attempt to withdraw the vast bulk of covered local government employees.[33]

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[32] The Court has pointed to similar considerations in cases involving due process challenges to federal legislation that impaired pre-existing contracts, requiring the party asserting unconstitutionality to demonstrate " 'that the legislature has acted in an arbitrary and irrational way.' " *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984), slip op. 10 (quoting *Turner Elkhorn Mining*, 428 U.S. at 15). See *National Rail Passenger Corp.*, slip op. 21, 25.

[33] While participation in Social Security may impose added expense on state and local government employers, that circumstance in itself plainly does not amount to a taking. See *Penn Central*, 438 U.S. at 131. Cf. *Allard*, 444 U.S. at 65-66; *Goldblatt* v. *Hempstead*, 369 U.S. 590 (1962); *Hadacheck* v. *Sebastian*, 239 U.S. 394 (1915). That is particularly true of legislation, like the 1983 amendment, that is designed to equalize the benefits and burdens of " '"doing business in a civilized community" ' " (*Monsanto*, slip op. 18 (citations omitted)), and that may, as a result, be expected to confer "an average reciprocity of advantage." *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 415 (1922). See *Penn Central*, 438 U.S. at 147 (Rehnquist, J., dissenting).

Finally, the 1983 amendment did not work an impermissible interference with "reasonable investment-backed expectations." It is difficult to discern *any* investment on the part of appellees that is frustrated by the elimination of Section 418's termination provision. And given the power retained by Congress to enact changes in the System as a whole (see pages 26-29, *supra*), any expectation on the part of appellees that they would never be required to participate in Social Security against their will cannot be deemed reasonable. See *Monsanto*, slip op. 17; *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 161 (1980). In these circumstances, the amendment to Section 418(g) cannot be said to violate "the dictates of ' "justice and fairness." ' " *Allard*, 444 U.S. at 65 (citations omitted).

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

RICHARD K. WILLARD
Assistant Attorney General

KENNETH S. GELLER
Deputy Solicitor General

CHARLES A. ROTHFELD
Assistant to the Solicitor General

WILLIAM KANTER
DOUGLAS LETTER
Attorneys

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